

American Economics Group

Clear and Effective Economic Analysis

Presentation for:

Multistate Tax Commission 7/31/03

Charles W. de Seve, Ph.D.

www.AmericanEconomics.com

Business Tax sheltering :

- **Growing State Tax Erosion**
- **Dramatic Increase over Last 10 Years**
- **Volatile & Undependable Revenue Source**

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Estimating Models by Michael K. Evans, Ph.D.

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Clear and Effective **Recession Recovery: Slow Growth**

- **Corporate/Business Profits Tax**
 - **Lagged Loss Write-offs**
 - **Growing Tax Avoidance**
 - **Employment Factor Falling**

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Each State's Business Tax Loss Depends Upon:

- ✓ Each State's Mix of Industry
- ✓ Aggressive Tax Avoidance / Tax Planning
- ✓ Size Mix of Companies (**higher avoidance for large multi-state firms**)
- ✓ Migration of jobs

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Erosion of State Taxes from Tax avoidance / Planning:

- **Personal Income Tax:**
 - **Loss growing slowly**
 - **Gamesmanship at higher incomes**

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Erosion of State Taxes from Tax avoidance / Planning:

- **General Sales Tax:**
 - **Loss growing moderately**
 - **Internet sales prime cause of growth**
 - **Other loss factors stable**

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Erosion of State Taxes from Tax avoidance / Planning :

- **Corporation Tax:**
 - **Loss growing rapidly**
 - **Transfer pricing / location strategy**
 - **Domestic & International involved**

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Loss of State Taxes in

- **Corporation/Business Tax: \$15 bil.**
- **Sales Tax: \$25 bil.**
- **Personal Income Tax: \$11 bil.**

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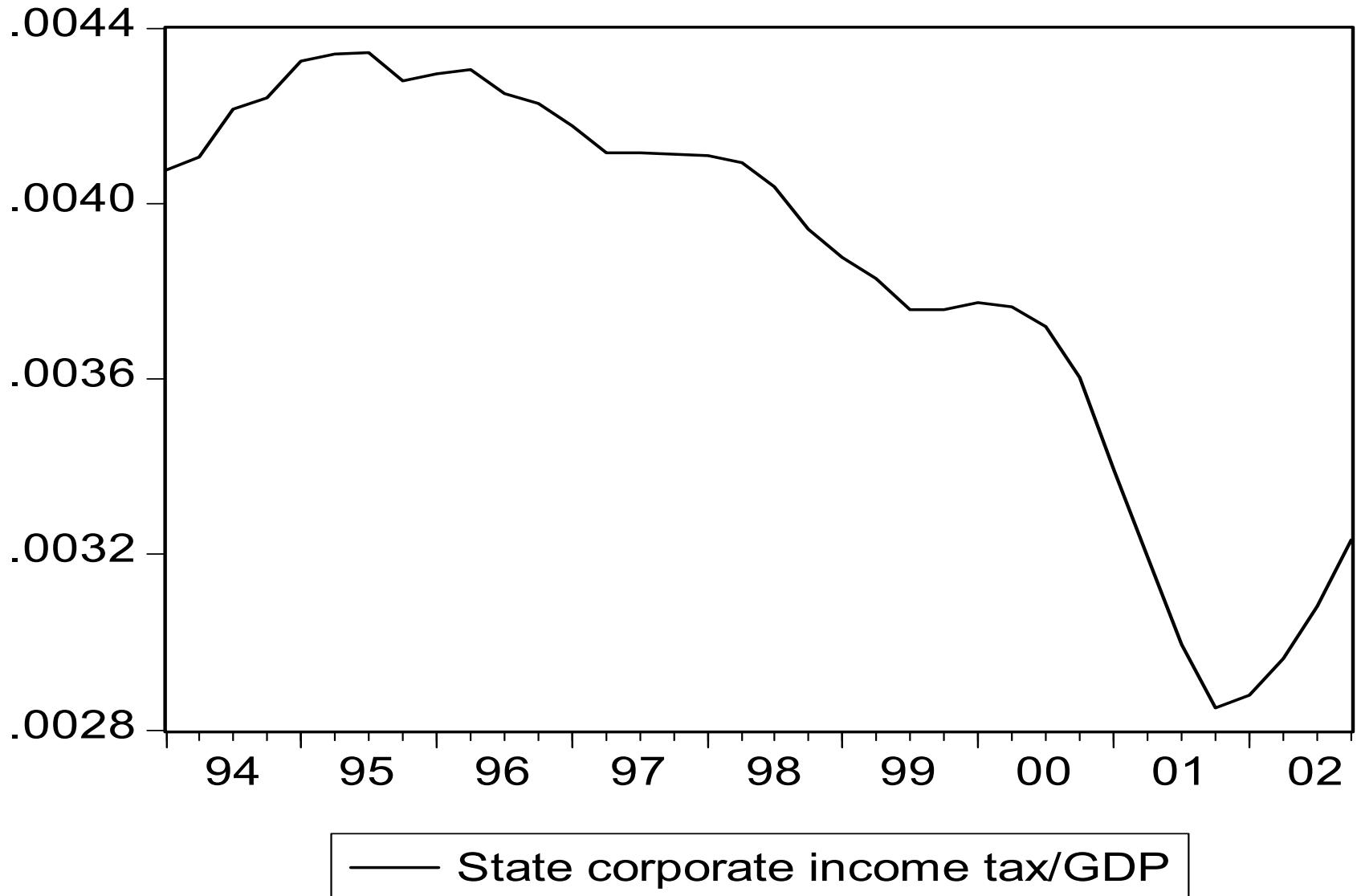
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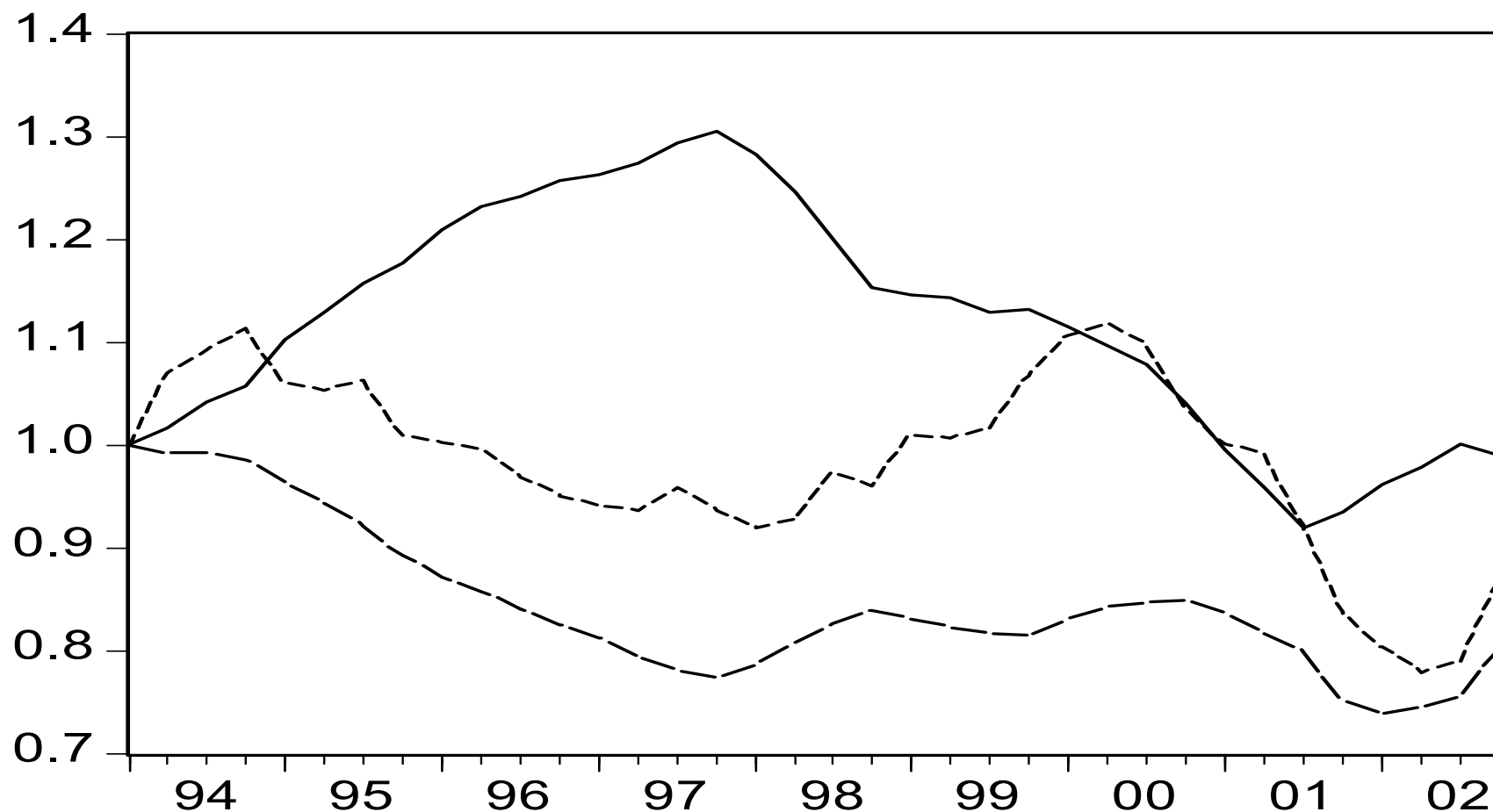
Total Loss of State Taxes for Entire United States

- **\$51 billion loss in 2001**
- **And Growing**

Ratio of state and local corporate income taxes to GDP,
taking into account all three factors causing the decline



Four-quarter moving averages of the ratio of profits/GDP
Federal corporate taxes to profits, and state and local
corporate taxes to profits



— Corporate profits/GDP
- - - Fed corporate taxes/profits
- . - State & local corporate taxes/profits

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Sorting States into Four Groups :

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Total Annual Loss from Tax Avoidance / Planning: Combined PIT, Sales & Corp. Taxes

- **Tier 1:** Over \$1.5 bil. Per year
- **Tier 2:** \$750 mil. to \$1.5 bil.
- **Tier 3:** \$300 mil. to \$750 mil.
- **Tier 4:** \$150 mil. to \$300 mil.
- **Tier 4:** Under \$150 mil.



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Highest Tax Avoidance Loss

Tier 1: Losing over \$1.5 billion/year

California

New York

Florida

Michigan

Illinois

Pennsylvania

New Jersey

Tax Avoidance Loss

Tier 2: Losing between \$750 mil. and \$1.5 billion/year

Massachusetts

Ohio

Texas

Georgia

North Carolina

Minnesota

Indiana

Wisconsin

Virginia

Tax Avoidance Loss

Tier 3: Losing between \$300 mil. and \$750 million/year

Maryland

Louisiana

Washington

Oregon

Tennessee

Alabama

Arizona

Kansas

Connecticut

Mississippi

Missouri

Oklahoma

Colorado

Arkansas

Kentucky

Iowa

South Carolina

Utah

Tax Avoidance Loss

Tier 4: Losing between \$150 mil. and \$300 million/year

New Mexico

Nevada

Hawaii

Maine

West Virginia

Alaska

Nebraska

Rhode Island

Idaho

New Hampshire

Lowest Tax Avoidance Loss

Tier 5: Losing under \$150 million/year

Delaware

Montana

North Dakota

Vermont

South Dakota

Wyoming

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Sorting States into Four Groups :

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**Total Percentage Loss from Tax Avoidance / Planning:
Combined PIT, Sales & Corp. Taxes**

- **Tier 1:** Losing over 7.5% of revenue
- **Tier 2:** Losing between 6.5% - 7.5%
- **Tier 3:** Losing between 5.0% - 6.5%
- **Tier 4:** Losing under 5.0%



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Tax Avoidance Loss Multiple Taxes

Tier 1: Losing over 7.5% of Revenue/year

Alaska

Massachusetts

Tennessee

New York

Michigan

New Jersey

Indiana

Georgia

New Hampshire

Florida

California

Mississippi

Arizona

Kansas

Illinois

Tax Avoidance Loss Multiple Taxes

Tier 2: Losing between 6.5% to 7.5% /year

Idaho

Maine

Utah

New Mexico

Minnesota

Arkansas

Nebraska

West Virginia

Pennsylvania

Ohio

Colorado

North Carolina

Wisconsin

Hawaii

South Carolina

Maryland

Connecticut

Tax Avoidance Loss Multiple Taxes

Tier 3: Losing between 5.0% to 6.5% /year

Oregon

Rhode Island

Iowa

South Dakota

Missouri

Kentucky

Virginia

Louisiana

Tax Avoidance Loss Multiple Taxes

Tier 1: Losing under 5.0% of Revenue/year

North Dakota

Montana

Washington

Nevada

Alabama

Texas

Oklahoma

Vermont

Delaware

Wyoming

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States can Augment their Conventional Auditing:

- **Section 482 approach:**
 - Statistical analysis generates tax bills
 - Different from statistical audit sampling
 - Domestic & international included
 - Combined data not needed

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Federal 482 Little Used but Has High Potential FOR STATES:

- **Federal use in APA**
- **Not much litigation**
- **Few resources devoted to it**
- **Data & analysis shortcomings**

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States Can Take 482 Action:

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- **States have the DATA (1120's)**
- **States have AUTHORITY**
 - ✓ 15 clearly have authority in current law
 - ✓ Many others probably have authority
 - ✓ Some will require legislation



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Tests Underway Now:

- **Two states participating**
- **Developing company-by-company data**
- **Estimates of 482 potential yield**

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